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SUBJECT: IRAQI CAPITAL AT WORK: PEPSI INTERNATIONAL AND THE BAGHDAD
SOFTDRINK COMPANY

SUMMARY:

¶1. (SBU) SUMMARY: An Iraqi investment bank's takeover of the mixed-owned enterprise (MOE) Baghdad Softdrink Company could be a model for moving the stagnating MOE sector forward. Since gaining a controlling stake of Baghdad Softdrink, the bankers have brought in capital and management expertise to resolve quality and labor issues. Over a year old, the venture has successfully increased employment, tripled the company's production, and brought \$250 million of investment to East Baghdad. END SUMMARY

DRINKING FROM THE TIGRIS

¶2. (U) Baghdad Softdrink was founded in 1950 and became an official Pepsi franchise in 1984, covering the middle of Iraq. Located in the Zafaraneeya Industrial Park in East Baghdad amidst a cluster of large (1,000- 5,000 employees) mixed-owned enterprises, it suffered declines in productivity, capacity, and quality experienced by other MOEs in recent years. The Company employs about 1,200 workers, not including auxiliary services such as drivers and agents is traded on the Iraqi Stock Exchange. It is 51 percent state-owned.

¶3. (U) Shortly after the liberation of Baghdad, Pepsi International resumed ties with Baghdad Softdrink and provided management and production training from Pepsi's Beirut offices. Utilizing fellow Arabic speakers with post-conflict experience, Pepsi made a concerted effort effort to bring the company up to international standards. In addition, Pepsi International loaned Baghdad Softdrink approximately \$30 million to overhaul the plant and restart operations. Despite this assistance, production, quality, and profit remained flat.

BANKERS TAKE THE PEPSI CHALLENGE

¶4. (SBU) In late 2007, Baghdad Softdrink approached Al-Bilad Islamic Bank, owned by the Al-Hassaney family, for help servicing the loans from Pepsi. Harith Yahya, a family member and managing director of an Al-Bilad subsidiary, proposed a debt-for-equity mechanism and by March of 2008, Al Bilad had purchased a controlling 40 percent stake of the company, reducing the GOI share to 14 percent. The bankers immediately made radical changes to the company's operations, installing new management software, QA/QC procedures, and a finger-print ID system for workers. According to Harith, production over the last year has tripled to approximately 3 million cans per day, and the market value of the company is up 30 percent. Hundreds of new trucks began bringing raw materials and finished product in and out of the nearly idle Zafaraneeya Industrial Park. Notably, Pepsi International recently fully certified Baghdad Softdrink for meeting all of the company's quality standards.

LABOR TROUBLES BUBBLE UP . . . AND FLATTEN OUT.

¶5. (U) The bankers immediately ran into challenges with their labor force. Harith explained that the workforce lacked training and "mentality." The new management instituted a "performance based" bonus system and demanded workers show up for work. Within days of taking the helm, Harith found himself locked in the executive

suites, trapped by 750 workers protesting the changes in management.

Al-Bilad installed a private security company and threatened to shut down production unless the union ceased disrupting work. A year later, Harith reports that attendance is up to "100 percent," the company has begun hiring new drivers and laborers, and with the new performance package, workers are getting paid "double their previous salaries."

REFRESHING INVESTMENT

16. (U) In the spring of 2009, Al Bilad broke ground for an ambitious expansion of operations to support Baghdad Softdrink operations. The bank is investing approximately \$250 million in greenfield facilities along the Zafaraneeya Industrial Park for facilities that will bottle water under the Aquafina brand, produce the currently imported aluminum cans and glass bottles used by the company, and recycle Baghdad's municipal waste paper into cardboard packaging for their products. The combined facilities, to be completed by the end of 2009, will employ 1,500 new direct hires. According to Harith, "It will be the largest bottling operation in the Middle East" by the end of 2009.

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17. (SBU) Al-Bilad has taken interest in other companies in the Industrial Park. In May of 2009, the bank took an undisclosed position in the MOE Electronic Industries Company (EIC). With EIC, Al-Bilad is following the Baghdad Softdrink model, providing expertise and taking a position on the Board of Directors. While Harith has examined deals with other MOE's in the industrial park, the bank deemed the deals too risky "because of the GOI's controlling ownership." Despite this, the bankers continue to look

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for opportunities in the mixed sector.

COMMENTS

18. (SBU) Iraqi Investment banks, bringing capital and management experience, offer the possibility of investment, employment, and productivity to the stagnating MOE sector. Banks are capable and willing to rehabilitate these companies, clearly seeing a potential for profit. With the improved security situation in East Baghdad, EPRT has seen an increased activity and interest from serious investors. Indeed, Harith himself said that the deciding factor was "the incredible turnaround in security in the area provided by CF and ISF over the past year." In the majority of these enterprises, the GOI continues to hold over 51 percent ownership. Until the GOI begins to cede its stranglehold of control on the mixed sector, and its state owned enterprises as a whole, it will likely continue to lose jobs and opportunities for the Iraqi economy. Sadly, the case of Baghdad Softdrinks and Al-Bilad might become the exception.

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